"marketing" efforts on behalf of BSLD are consistent with the nondiscrimination requirements of section 272(c).

87. This concludes my affidavit.

FCC DOCKET CC NO. 98-121
AFFIDAVIT OF PATRICIA A. MCFARLAND

I declare under penalty of perjury that the foregoing is true and correct. Executed on July 22, 1998.

Patricia A. McFarland

Patricia A. McFarland

Sworn to and subscribed to before me

this 22nd day of July, 1998

Sheila C. Colbert

Notary Public Notary Public Gwinnett County, Georgia
My Commission Expires March 14th, 1999

ATTACHMENT 1

BELLSOUTH

ifill

PAST TRANSACTIONS

BST and BSLD have conducted transactions. BST has performed and billed BSLD for the following described services performed through August 31, 1997 (certain bills delivered by BST totaling $44,500 are under investigation and are not included here):

(1)Customer Billing Services:
Initial planning associated with setting up end user billing accounts for the initial BellSouth Long Distance product offering. Included planning associated with rating of calls, discounting of rated calls, computing, billing, and collecting taxes, bill presentation, and billing information flow between BST and BSLD. Also included documentation of work requirements for Information Technology (IT) coding. These services were provided to BSLD at fully distributed costs. The amount for these services totaled $645,500. Services were provided from April, 1996 through August, 1997.

(2)Project Management:
Project management within BST for implementation of the sale of long distance products on an agency basis for BSLD. Provided assistance with issues such as the introduction, billing, and support of products through BST as a sales agent. These services were provided to BSLD at fully distributed costs. The amount of these services totaled $195,000. Services were provided from June, 1996 through August, 1997.

(3)Network - Infrastructure Planning and Management - Provision of CIC Code:
BST provided BSLD the rights to use 377 as a Carrier Identification Code (CIC). These services were provided to BSLD at fully distributed costs. The amount for these services totaled $481,700. Services were provided from December, 1996 through July, 1997.

(4)Interconnect Services - Advanced Intelligent Network (AIN):
BST provided initial application software development for a Proprietary Calling Card Service Package. The software is for use in BSLD's Advanced Intelligent Network. This service was provided to BSLD at fully distributed costs. The amount for this service totaled $80,000. Services were provided in November and December, 1996.

(5)Sales Channel Planning and Design:
BST provided planning and design services required to integrate

long distance products into BST marketing plans and operations. Included development of specifications for taking service orders, handling of customer inquiries, credit policies, adjustment procedures, testing of sales and billing procedures, and training of service representatives. These services were provided to BSLD at fully distributed costs. The amount for these services totaled $1,445,900. Services were provided from April, 1996 through August, 1997.

(6)Initial Planning:
Initial planning services during the start up phase for BSLD. These services were provided to BSLD at fully distributed costs. The amount for these services totaled $23,700. Services were provided from April, 1996 through August, 1996.

(7)Information Technology - Billing Systems:
BST provided services associated with the development, design, coding, and testing of systems, including infrastructure changes, to bill long distance products to end users based on BSLD's billing requirements and of reports to verify compliance with sales activities. Included changes necessary to provide customers a consolidated bill for local and long distance services. These services were provided to BSLD at fully distributed costs. The amount for these services totaled $2,995,400. Services were provided from April, 1996 through August, 1997.

(8)Information Technology - Product Integration:
BST provided services to implement and test the systems interface between BST and BSLD for long distance products. Included development of initial account structure, systems changes for the acceptance of orders and customer inquiries, development of systems for the acceptance of BSLD product codes, and development of databases to store BSLD customer information. These services were provided at fully distributed costs. The amount for these services totaled $622,000. These services were provided from April, 1996 through July, 1997.

(9)Employee Expense Correction:
During the first half of 1996, employees from BST accepted positions at BSLD. BST continued to incur payroll and benefit costs for a brief time after the employees accepted positions and began work at BSLD. BST billed these costs back to BSLD. This transaction was at fully distributed costs. The amount of the transaction totaled $194,800.

(10)Investment Related Costs - PCs:
Depreciation of computers for BST employees assigned to BSLD-related projects. This transaction was at fully distributed cost. The amount of the transaction totaled $30,700. Services were provided from September, 1996 through August, 1997.

(11)Interoffice Testing - CO Switch:
BST provided facilities, including SCPs and a Lucent #5ESS switch, and staff to test BSLD equipment. These services were provided at BST's prevailing company price. The amount for these services totaled $42,800. These services were provided in June, 1997.

(12)Telecommunications Services:
BST provided local phone service to BSLD at standard tariff rates. The amount for these services totaled $166,500. Services were provided from April, 1996 through August, 1997.

(13)End to End Testing:
BST provided facilities in order to test various electronic and manual interfaces and systems between BST and BSLD. These services were provided at standard tariff rates. The amount for these services totaled $2,309. Services were provided through August, 1997.

(14)Collocation:
BST has granted BSLD the right to occupy certain enclosed areas within BST's central offices located at: Courtland Street Office, Atlanta, Georgia; Orlando Main Office, Orlando, Florida; New Orleans Main Office, New Orleans, Louisiana; and Caldwell Street Office, Charlotte, North Carolina. This right is granted for a period of two years from the date BSLD's equipment becomes operational. These services were provided at BST's prevailing company price. The amount for these services totaled $2,204,000. Services were provided from June, 1997 through August, 1997.

(15)Mail Service:
BST provided daily inbound and outbound mail services to BSLD. These services included the pick-up and delivery of mail to and from other BellSouth entities as well as pick-up and delivery of mail to and from external entities. Pick-up and delivery occurs daily at BSLD's principal place of business, 32 Perimeter Center East, Atlanta, Georgia, 30346. These services were provided at fully distributed costs. The amount for these services totaled $67,800. Services were provided from January, 1997 through August, 1997.

ATTACHMENT 2

BellSouth File
cc: Beth Dunn

A.J. Calabrese
Date 5/15/97
Log Code I9

RECEIVED MAY 20 1997

AT&T

William J. (Jim) Carroll
Vice President

Room 4170
1200 Peachtree St., NE
Atlanta, GA 30309
404 810-7262

May 15, 1997

Mr. Charlie Coe
Group President - Customer Operations
BellSouth Telecommunications, Inc.
Room 4514
675 West Peachtree Street, N.E.
Atlanta, Georgia 30375

Dear Charlie:

Attached is a letter from BellSouth to an AT&T employee who is participating in the Local Service Readiness Test between our companies. Other test participants, including those participating in the Unbundled Network Element concept testing in Florida, have received similar letters from BellSouth. Through the letter, BellSouth is using "requests to switch" to impermissibly market AT&T's customers.

Because AT&T is using services provided by BellSouth to offer competing local service, AT&T is concerned about such BellSouth contacts and their potential anti-competitive impact on AT&T's efforts to enter the local exchange market. Therefore, AT&T requests that BellSouth discontinue the practice of contacting AT&T's customers in this manner.

Sincerely,

Jim

William J. Carroll

Attachment
cc: Al Calabrese
Jerry Hendrix
Mark Feidler

BELLSOUTH

BellSouth Telecommunications
P. O. Box 189170
Columbia, SC 29202-3170

April 8, 1997
(770)593-3413

DEBBIE HIGHTOWER
% PAMELA RAGLAND
ATT LSO RM 10125-A
1200 PEACHTREE ST
ATLANTA GA 30309

Dear Customer:

We recently received your request to switch your local phone service to another carrier. Although we are disappointed to lose you as a customer, be assured that we have already handled your request and you will shortly receive your final bill as confirmation.

If you were unaware that we received a request to switch your service, please notify us of the problem so that we can correct it. Call us any day, at any time, at 1-800-733-3285.

If you have elected to leave BellSouth, we'd like you to consider coming back. Please know that we are committed to providing the most advanced technology, the highest level of service and the best value for all of your communications needs. If you would like to resume BellSouth Service, or if you would like to hear more about what we have to offer, please call 1-800-733-3285.

We value you as a customer and look forward to serving you again in the near future.

Sincerely,

Bob Daniel

Bob Daniel, General Manager-Consumer Services

ATTACHMENT 3

PUC PROJECT NO. 16251

INVESTIGATION OF SOUTHWESTERN BELL TELEPHONE COMPANY'S ENTRY INTO THE TEXAS INTERLATA TELECOMMUNICATIONS MARKET	§ § § § §	**PUBLIC UTILITY CO OF TEXAS**

COMMISSION RECOMMENDATION

The Texas Public Utility Commission (the Commission) and the telecommunications industry have worked steadily since the passage of the federal Telecommunications Act of 1996 (FTA96) to negotiate and arbitrate interconnection agreements that will facilitate local competition in Texas. Pursuant to FTA96, new entrants have the legal authority to enter the local market in Texas through resale, unbundled network elements (UNEs), and interconnection. FTA96 § 251 (47 U.S.C. § 251).

In order to provide in-region interLATA services, Southwestern Bell Telephone Company (SWBT), a Bell Operating Company (BOC), must establish that the local telecommunications market is irreversibly open to competition. Specifically, Section 271 of FTA96 requires SWBT to establish that

- it satisfies the requirements of either Section 271(c)(1)(A), known as "Track A," or Section 271(c)(1)(B), known as "Track B";
- it is providing the 14 checklist items listed in Section 271(c)(2)(B) pursuant to either a Track A state-approved interconnection agreement or a Track B statement of generally available terms (SGAT);
- the requested authorization will be carried out in accordance with the requirements of Section 272; and
- SWBT's entry into the in-region interLATA market is "consistent with the public interest, convenience, and necessity." Section 271(d)(3)(C).

Although the Federal Communications Commission (FCC) ultimately determines whether SWBT has established its entitlement to enter the interLATA market pursuant to Section 271, the statute directs the FCC to consult with state commissions. The FCC relies upon state commissions to develop a complete factual record.

SWBT filed its application to provide in-region interLATA service in Texas on March 2, 1998 with the Commission. On April 7, 1998, the Commission held an open meeting at SWBT's Local Service Center (LSC) in the Dallas-Ft. Worth area and on April 21st through the 25th, the Commission held an extensive hearing on SWBT's application. Many competitive local exchange companies (CLECs) and other parties participated in the Commission's 271 proceeding.

SWBT has done much in Texas to open the local market to competition. Notwithstanding that fact, if the Commission were asked to give a recommendation to the FCC today, it regrettably would be required on the record before it to say "not yet." The Commission files this Recommendation in an effort to provide SWBT with guidance on what the Commission believes than 30 lines or that have any design services such as Centrex. SWBT must enhance the ability of its interfaces to handle these order types or demonstrate that parity is provided at this time;

29. SWBT shall demonstrate that its back-end systems are operationally ready, to assure performance parity between CLECs and SWBT's retail operations for POTS (plain old telephone service) order completion, FOCs, installation intervals, trouble reports, design services, billing accuracy, or billing timeliness.

Section 272 Compliance

SECTION 272 COMPLIANCE: Pursuant to section 271(d)(3)(B), has SWBT demonstrated that the requested authorization will be carried out in accordance with the requirements of section 272?

RECOMMENDATIONS: The Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to compliance with Section 272.

1. Although SWBT has established a separate affiliate to provide interLATA services in Texas, the actual corporate structure must be clarified. The Commission cannot determine from the record which SBC subsidiary and/or d/b/a will be used to provide interLATA services in Texas. SWBT shall supplement the record with the necessary information;
2. It is the Commission's position that the independence and separation of the SBLD board and officers from SWBT is not absolutely clear in the record. The record on this issue shall be further developed and clarified so that a determination can be made as to whether SBLD's officers, directors, and employees are separate from SWBT and its corporate chain of command;
3. SWBT's postings on the internet do not clearly delineate the services which are provided by SWBT to SBLD, the identified interLATA affiliate. The internet postings shall clearly identify this information. Additionally, the internet postings shall be revised to indicate which of the services are provided by SWBT to SBLD for Texas, for Oklahoma, or any other state served by the three SBC BOCs, or services provided by SWBT to support SBCS in its other activities outside the SWBT service areas;
4. SWBT shall make available public access to information on transactions between the BOC and the interLATA affiliate at the BOC's headquarters. After the hearing, SWBT in an affidavit reported it would move the records to San Antonio, Texas during the month of June 1998. SWBT should file a follow-up affidavit once the records are available in San Antonio. The Commission must have proof that the records will remain available in San Antonio pursuant to the FCC's order;
5. SWBT shall post on the internet a written description of the asset or service transferred along with the terms and conditions;
6. There is insufficient information to evaluate if transactions are fairly and accurately valued. SWBT shall provide such additional information, so the Commission can determine which of the posted services and assets would be available on an equal pricing basis to a competitor of SBLD;
7. Transactions between February 1996 and the date of approval to initiate interLATA services shall be disclosed and made subject to "true-up;"
8. SWBT shall provide additional information to enable the Commission to evaluate if transactions are arms-length between the affiliates;
9. SWBT shall limit its use of "CONFIDENTIAL" and "PROPRIETARY" classifications to those

transactions that meet the FCC guidelines for such protections;

10. The record shall be developed further as to SWBT's practices regarding the use of "CONFIDENTIAL" and "PROPRIETARY" restrictions on documents. If contracts between SWBT and its interLATA affiliate are improperly so marked, then, the Commission's position is that SWBT does not meet the public disclosure requirements of Section 272;
11. The audit report to Texas must report on transactions from all three SBC BOCs, summarizing the total support services from each BOC, reporting the specific services received by the long distance affiliate from each BOC, and reporting on the allocation of expenses within the SBCS organization by subsidiary and by d/b/a title;
12. The Commission has concerns regarding marketing, but recognizes the FCC's decision in BellSouth/South Carolina. The Commission, nonetheless, has concerns that the strong recommendation of its affiliate by SWBT and the warm-hand-off to the affiliate would not pass any arms-length test. If a customer truly does not readily state a long distance company choice, then random assignment of a carrier is preferable.

The following Commission Staff assisted in this proceeding:

Donna Nelson
Howard Siegel
Eric White
Nara Srinivasa
Elizabeth Barton Jones
Stephen Mendoza
Linda Hymans
Lynne LeMon
John Costello
Bih-Jau Sheu

Katherine Farroba
Ericka Kelsaw
Wes Oliver
Meena Thomas
Daphne Allen
Janis Ervin
Sid Lajzer
Anne McKibben
Valerie Seely
Tracie Monroe

ATTACHMENT 4

CALIFORNIA PUBLIC UTILITIES COMMISSION
TELECOMMUNICATIONS DIVISION
INITIAL STAFF REPORT

Pacific Bell (U 1001 C) and Pacific Bell Communications
Notice of Intent to File Section 271 Application
For InterLATA Authority in California

July 10, 1998

CHAPTER IV: OTHER TELECOMMUNICATIONS ACT REQUIREMENTS

A. SECTION 272

FCC Guidance in Prior 271 Filings

Section 271(d)(3)(B) requires that the BOCs' request for interLATA authority be carried out in accordance with section 272 of the Act.

Section 272 requires that a BOC (or its affiliate) must provide interLATA telecommunications services through a separate affiliate. It imposes five structural and transactional requirements upon the long distance affiliate. In evaluating the compliance of a BOC, the FCC determined that it may look to both the BOC's past and present behavior to make a predictive judgment concerning whether the BOC will comply with section 272. (Ameritech ¶ 347.)

Specifically, the BOC long distance affiliate must operate independently from the BOC; it must have books, records, and accounts which are separate from the BOC affiliate; it also must have separate officers, directors, and employees from the BOC affiliate; the BOC must treat the section 272 affiliates on an arms-length, nondiscriminatory basis. (Ameritech ¶¶ 349-353.) All transactions between the BOC and the section 272 affiliates must be publicly disclosed, and this disclosure must include the actual rates used to value the transactions, not simply stating the valuation method employed. If a BOC has transferred facilities and capabilities to any other affiliates, it must disclose transactions between those affiliates and its long-distance affiliate. (Ameritech ¶¶ 363-373.) Additionally, the section 272 affiliate may not obtain credit where upon default the creditor would have recourse against the assets of the BOC affiliate.

Issues Selected for the Collaborative Process

The Commission recommends the following, the details of which could be developed in the collaborative process.

Provide documentation of company policies and procedures related to the access to and dissemination between affiliates and LEC operations of competitive carrier CPNI and other proprietary information. Specifically, Pacific should provide proof that it is not using competitors' proprietary information for its own use. A specific example provided by AT&T (Olsen Aff.) is an allegation that Pacific misappropriated IXC trade secrets by passing on exchange access data.

Provide verifiable evidence of separate officers for Pacific and all of its 272 affiliates. It is staff's position that the independence and separation of Pacific's and PB Com's boards of directors and officers from SBC is not absolutely clear, based on the record to date. The record on this issue shall be further developed and clarified so that a determination can be made as to whether officers, directors, and employees (as defined by the FCC) of all Pacific's 272 affiliates are separate from Pacific.

Staff believes that it is necessary to determine the appropriate level of detail for "adequate disclosure of transactions" as well as Pacific's compliance with providing the information in a timely, appropriate fashion. In the collaborative process, staff would like to examine whether the following issues are appropriate or accurate concerns:

There is insufficient information to evaluate if transactions are fairly and accurately valued. Staff believes that Pacific should fully explain its valuation procedures and methods, and develop a process to provide such additional information, as considered necessary by staff for the Commission to determine which of the posted services and assets are available, on an equal pricing, basis to a competitor of PB Com;

Pacific should post on the Internet a written description of the asset or service transferred along with all terms and conditions;

Pacific should identify all transactions between itself and its 272 affiliates between the effective date of FTA 96 and August 12, 1997 for staff review. If considered appropriate by staff, said transactions between February 1996 and the date of approval to initiate interLATA services shall be disclosed and made subject to "true-up";

Pacific should provide additional information, as considered necessary by staff, to enable the Commission to evaluate if transactions are arms-length between the affiliates;

The record should be developed on FCC requirements or guidelines regarding the use of "Confidential" and "Proprietary" classifications to provide a basis for evaluating Pacific's compliance with any requirements or guidelines applicable to the use of said terms;

The record should be developed further as to Pacific's practices regarding the use of "CONFIDENTIAL" and "PROPRIETARY" restrictions on documents;

Criteria, procedures, and processes should be developed to provide data to fully demonstrate that the section 272 affiliates are treated on an arms-length basis and that non-affiliated carriers are treated the same as, and under that same terms and conditions, as section 272 affiliates for the purchase of tarriffed services, and where determined by staff to be appropriate, for the purchase of non-tarriffed services;

- Develop a record on the need for the need to conduct periodic internal audits for ongoing evaluation of Pacific's, and all of its subsidiaries and affiliates, and continued compliance with all requirements of section 272.

Finally, staff is concerned about any possibility that Pacific is providing central office information to affiliates that it is not making available to third-parties. In particular, staff is concerned that affiliates may not have been required to adhere to the same collocation request process(es) required of CLECs. Pacific should fully explain the company policies for affiliate and non-affiliate collocation in central offices, and provide information to demonstrate that CLEC's have not been treated differently than Pacific's affiliates in the provision of collocation space.

On a preliminary basis, information that staff finds relevant includes, but is not limited to: a list of the central offices where affiliates are located and the related amount of space in each central office; when the affiliate first obtained collocation space in each central office; a full explanation of the actual process(es) employed to evaluate affiliate requests for space in each of the respective central offices; and a list of each central office where non-affiliated third parties have requested collocation space but were turned down and an indication of whether affiliates have collocation space in those central offices.

B. PRESENCE OF A FACILITIES-BASED COMPETITOR

Section 271(c)(1)(A) of FTA96 requires the presence of a facilities-based competitor. A BOC is seen to have met this requirement if it has entered into one or more binding agreements that have been approved under section 252 with one or more unaffiliated providers of telephone exchange service to residential and business subscribers. Such telephone service may be offered exclusively over the competing provider's own facilities or "predominantly" over its own facilities, in combination with the resale of telecommunications service provided by another carrier.

FCC Guidance in Prior 271 Filings

The FCC has provided significant direction to help determine the presence of a facilities-based competitor. The four major sub-issues the FCC has addressed are:

Has the BOC entered into one or more binding agreements under 252?

Has the BOC provided access and interconnection to unaffiliated competing providers of local exchange service?

Are competitors providing service to both business and residential customers?

Is service being provided exclusively or predominantly over the CLEC's own facilities?

In the Ameritech/Michigan application, Ameritech relied on three interconnection

ATTACHMENT 5

REGIONAL AUDIT OF BELLSOUTH AND CERTAIN AFFILIATED COMPANIES

December 17, 1993

NATIONAL ASSOCIATION OF
REGULATORY UTILITY COMMISSIONERS
1102 Interstate Commerce Commission Building
Constitution Avenue and Twelfth Street, NW
Post Office Box 684
Washington, DC 20044-0684
Telephone No. (202) 898-2200
Facsimile No. (202) 898-2213

Price: $30.00

there is a significant difference between discovery and auditing. The brief points out that the PSC internal procedures clearly distinguishes auditing from discovery and excludes auditors from the discovery process.

On July 19, 1993, Commissioner Clark held a "status" meeting in Docket No. 920160-TL. At this meeting all past due and incomplete responses to staff audit requests were addressed. New due dates were established. In response to a Company motion for more time to respond to audit requests, Commissioner Clark ruled that a fifteen day turnaround time is appropriate recognizing the complexity of this audit. The Commissioner made it clear that this was an audit not subject to discovery rules and the fifteen days was unique to this audit.

On August 27, 1993, Commissioner Clark held a second "status" meeting. At this meeting the Company represented that its affiliate, BellSouth Enterprises, to whom the Audit Team directed many requests, would comply to some of the audit requests but not under the timeframes established by Commissioner Clark. As a result, Commissioner Clark sent a letter to John Clendenin, CEO of BellSouth Corporation, requesting his assistance in getting BellSouth Enterprises to comply to audit requests on a timely basis. The Company responded by stating that "BellSouth Enterprises is committed to cooperation with the Florida Commission, within the law and the extent of its available resources, to provide timely and complete responses to requests that your audit team may make." Emphasis added. Obviously, the level of cooperation depends on the Company's interpretation of "within the law" and its designation of what resources will be available.

On October 4, 1993 the Florida Supreme Court heard arguments regarding access to affiliate records. As of this writing, a decision is pending.

On November 24, 1993 the Audit Team provided the Company a draft of the audit report and workpapers. The purpose was to give the Company time to verify the statements of facts in the report and designate claimed proprietary information in preparation for the exit conference scheduled for December 10, 1993. On December 8, 1993, the Company informed the Audit Team it will not attend the exit conference and plans on responding to the audit by way of rebuttal testimony and a "parallel" audit conducted by Deloitte and Touche CPA firm.

In summary, the Audit Team attempted to evaluate whether cross subsidy exists between BSTI's regulated and non regulated operations which is a national concern as evidenced by the previously mentioned NARUC resolution. Because of limited resources, the staff through analytical review limited its audit program to a relatively small number of affiliates and transactions. The Company displayed a consistent pattern of obstructionist behavior since May of 1992. Since an open and cooperative environment is essential for effective auditing, many of the audit objectives were not fulfilled. The proliferation of diversification activities by not only BellSouth but other telephone and electric companies has complicated the regulatory process. It will require regulation beyond the utility. The extent of that regulation needs to be defined.

ATTACHMENT 6

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

The BellSouth Telephone Operating Companies — AAD 93-148

ORDER TO SHOW CAUSE

Adopted: February 24, 1995; Released: March 3, 1995

By the Commission:

1. At the direction of this Commission, the National Exchange Carriers' Association, Inc. ("NECA") hired Ernst and Young to conduct an independent audit of carrier-reported adjustments to the Common Line ("CL") revenue pool for 1988 and the first quarter of 1989.[1] Our subsequent review of that Commission-mandated audit revealed apparent violations of our accounting rules and reporting requirements by BellSouth Telephone Companies ("BellSouth") during the audit period. These apparent violations may have continued beyond the period covered by the audit. This Order to Show Cause sets forth those apparent violations and directs BellSouth to show cause why this Commission should not: (1) issue a Notice of Apparent Liability for Forfeiture ("NAL") for apparent violation of Section 220(d) of the Communications Act of 1934, as amended;[2] (2) require BellSouth to adjust its price cap indexes; and (3) require BellSouth to improve its internal processes to bring them into compliance with Commission rules and orders.

2. Enforcing our accounting rules and reporting requirements is essential for the Commission to carry out its statutory obligations to ensure that rates for telecommunications services remain just and reasonable. Our ability to carry out these obligations is impaired if we cannot rely upon the information that carriers are required to submit about the costs of their operations and their allocations of those costs, or if those allocations are made improperly. As the telecommunications marketplace continues to diversify, with carriers providing more and more nonregulated services, our enforcement of accounting safeguards will become even more important if we are to continue to protect ratepayers from being overcharged for interstate services.

I. BACKGROUND

3. Our rules require the LECs, on a monthly basis, to report to NECA their revenue, expense and investment data. NECA uses these data to compute each LEC's monthly pool shares.[3] Because LECs do not have complete data available when they first report to NECA, the LECs initially report estimated data. In the following months, the LECs are required to reconcile their estimates with actual results. To ensure the accuracy of the reconciliation process and because even the best accounting systems sometimes fail to prevent errors, NECA procedures allow the LECs twenty-four months to reconcile and correct previously submitted data. Thus, in each monthly "settlement cycle," LECs report estimated data for the current month as well as adjusted data for the preceding twenty-four months.

4. In the December 1988 settlement cycle, certain LECs reported unusually large adjustments to the CL pool. Commission staff audited the larger of these adjustments and found that they appeared to have been encouraged by NECA Board members representing the BOCs and further found them apparently inconsistent with the Commission's rules. As a result, the Commission issued *Notices of Apparent Liability for Forfeiture and Orders to Show Cause* against the BOCs that filed these adjustments.[4] The Commission also issued a letter of reprimand to the NECA Board of Directors and required, *inter alia*, that NECA hire an independent auditor to perform a comprehensive audit of significant adjustments the BOCs reported to the CL pool for 1988 and 1989.[5]

---

[1] NECA collects cost data, including revenue, expense and investment data, from all local exchange carriers ("LECs") on a monthly basis. These data are then used to develop LEC-specific revenue requirements which are designed to recover those LEC-incurred costs that are allocated to the interstate jurisdiction under our jurisdictional separations rules, 47 C.F.R. Part 36. The revenue requirement development process is called "pooling," because, initially, all LEC-submitted cost data are combined ("pooled") based on whether they are non-traffic sensitive (*e.g.*, CL) or traffic sensitive ("TS") in nature. Accordingly, NECA administers two revenue pools. Non-traffic sensitive, CL costs are pooled to develop CL revenue requirements, and TS costs are pooled to develop TS revenue requirements. The revenues required to recover CL costs are collected through (1) carrier common line charges billed to the interexchange carriers; (2) subscriber line charges billed to end users and other customers; and (3) surcharges assessed against special access customers. These charges are set forth in tariffs NECA prepares for pool members, primarily the smaller, independent LECs. Other LECs -- including the Bell Operating Companies ("BOCs") -- currently do not participate in the cost recovery pools and, instead, prepare their own access tariffs. As explained *infra*, however, the pools are calculated based on revenue data provided by all LECs, and revenue data reported to NECA by the large carriers will, therefore, affect the charges of pool members. Moreover, during the time period covered by the audit, our rules required all LECs to participate in the CL pool.

[2] 47 U.S.C. §220(d). The BellSouth operating companies are the South Central Bell Telephone Co. (SCB) and the Southern Bell Telephone and Telegraph Co. (SBT).

[3] 47 C.F.R. §69.605.

[4] *See, e.g.*, Southwestern Bell Telephone Co., *Notice of Apparent Liability for Forfeiture and Order to Show Cause*, 5 FCC Rcd 7179 (1990). The Commission subsequently entered into Consent Decrees with the carriers thus resolving these initial actions without determinations of liability. *See, e.g.*, Southwestern Bell Telephone Co., *Consent Decree Order*, 7 FCC Rcd 7692 (1992).

[5] Letter from Donna R. Searcy, Secretary, FCC, to Lawrence C. Ware, Chairman of the Board of Directors, NECA, 5 FCC Rcd 7183 (1990). The letter identified "significant adjustments" as individual adjustments of $100,000 or more that the BOCs had reported to the CL pool for 1988 and 1989 other than the adjustments that had been addressed in the Commission audit. The independent audit covered the fifteen data months from January 1, 1988 through March 31, 1989, after which time participation in the CL pool became voluntary and all BOCs left that pool. The letter, however, also required that the in-

5. NECA hired the public accounting firm of Ernst & Young to conduct the independent audit. Ernst & Young issued its report which NECA submitted to the Commission.[6] That report included numerous audit findings against the BOCs, including BellSouth; the conduct noted by Ernst & Young has a substantial impact on the CL pool as well as on the carriers' interstate telecommunications services customers. This is because NECA distributes access tariff revenue based on reported data. Moreover, since the reported adjustments to the CL pool involve misstatements or miscalculations of interstate costs and revenues historically used to develop the reporting carrier's access charges, and, after 1988, its price cap indexes, the reporting carrier's interstate access customers, as well as end users, are affected. Although the independent auditor's report addressed the effects of the BOCs' conduct only on the CL pool, Commission auditors are examining the effect on all interstate telecommunications services. Those of the independent auditor's findings that were directed against BellSouth and that warrant Commission action are the subject of our action here. These findings are summarized below. Attachment A provides the specific details of each finding, the Commission Rules that were apparently violated, and the companies' responses to those findings. Attachment B presents, in tabular form, a summary of the apparent violations and their revenue impacts as revealed by the record to date.

II. THE FINDINGS

6. Section 220(a) of the Communications Act grants to the Commission specific authority to "prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject [to the Act]...."[7] In turn, Section 220(d) authorizes the Commission to impose forfeitures on carriers who do not keep such accounts, records, and memoranda in the manner prescribed by the Commission. The findings in Attachment A appear to reveal conduct by the BellSouth carriers that violates Section 220 for the period that is the subject of the audit, namely, the period beginning January 1, 1988, and ending March 31, 1989.[8]

7. The independent auditor's findings that we address here involve the misstatement or miscalculation of some $6.2 million of interstate costs and revenues for the period from January 1988 through March 1989.[9] In the aggregate, these misstatements or miscalculations apparently benefited BellSouth to the detriment of the users of BellSouth's interstate services FNN These misstatements or miscalculations shifted costs between or among access elements, thus apparently understating or overstating BellSouth's interstate revenue requirements for particular services. The seriousness of the misstatements is compounded here not only because of the net impact and the extent of understatements and overstatements, but also because of the scope and number of the errors or apparent violations and the fact that some of them may have continued to the date of this *Order to Show Cause*. The findings reveal the BellSouth carriers' apparent failure to maintain their accounts, records, and memoranda in the manner prescribed by the Commission. To the extent that this conduct has continued, it must seriously undermine the Commission's confidence that BellSouth's accounts accurately reflect Commission-mandated accounting practices and reveal the true and lawful costs of BellSouth's interstate services. Moreover, and as explained more fully below, the apparent rule violations and misstatements may very well have led BellSouth to compute price cap indexes that likely would require correction.

8. In the following paragraphs we describe the accounting irregularities that have led us to issue this Order to Show Cause.

A. Apparent Cash Working Capital Violations

9. The independent auditor found that BellSouth's calculation of cash working capital allowances apparently violated Commission rules.[10] These allowances are supposed to reflect the average amount of investor-supplied capital needed to fund carriers' day-to-day operations.[11] Each cash working capital allowance is added to a carrier's ratebase, thereby increasing the earnings the carrier is allowed. The BellSouth carriers calculate their cash working capital allowances based on lead-lag studies.[12] In computing cash

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dependent audit "include adjustments reported after [the BOCs] left the pool on April 1, 1989" since carriers were allowed to submit adjustments for up to twenty-four months following a particular data month. *Id.* As a result, the independent auditor examined reported CL pool adjustments through March 1991.

[6] The Ernst & Young audit report is hereafter referred to as the "*Adjustments Report*." On February 11, 1993, the Commission concluded that this audit had complied with Commission directives and had been performed "with a high degree of skill and care," and that the independent auditor had "exercised sound professional judgment reflecting purposes of the [audit] and the information gathered during [its] course." *See* Letter from Donna R. Searcy, Secretary, FCC, to Robert A. McArton, Chairman of the Board of Directors, NECA, 8 FCC Rcd 1315 (1993).

[7] 47 U.S.C. §220(a).

[8] The apparent violations roughly fall into two categories for purposes of potential remedies. First, certain apparent violations found to fall outside the applicable limitations period for assessing forfeitures may, nevertheless, necessitate corrective action by the Commission. For example, the Commission may require adjustments to carrier price cap indexes to eliminate distortions caused by unlawful conduct. Second, other apparent violations, if found to be continuing or to have continued into the period covered by the limitations period, could support Notices of Apparent Liability for Forfeiture under Section 1.80 of the Commission's Rules, 47 C.F.R. §1.80, as well as support other remedies, such as price cap adjustments.

[9] These figures are based on estimates BellSouth provided to the independent auditor. *See* Letter from Bruce Baldwin, President, National Exchange Carrier Association, Inc., to Mr. Gerald P. Vaughan, Deputy Chief, Operations, Common Carrier Bureau, at BellSouth Attachment (Oct. 12, 1992). Although those estimates encompass most of the independent auditor's findings, BellSouth did not provide interstate impact estimates of the impact of certain findings on interstate rates and revenue requirements.

[10] *Attachment A*, at 1.

[11] *See Attachment A*, at 3 n.17.

[12] *See Attachment A*, at 1-2. Lead-lag studies measure cash inflows and outflows in relation to the time service is rendered. Revenue and expense items that are received or paid before a service is rendered are considered "lead" items, and revenue and expense items that are received or paid after service is rendered are considered "lag" items. Lead-lag studies determine the number of days between receipt of revenues and payment of expenses.

working capital allowances, carriers are allowed to add minimum bank balances required by banks to the results obtained from these lead-lag studies. The independent auditor found that BellSouth improperly used average daily ledger balances, rather than minimum bank balances, which resulted in an overstatement of its total interstate revenue requirement of $4.8 million.[13]

B. Apparent Jurisdictional Separations Violations

10. Responsibility for regulating telephone services is shared between this Commission, which regulates interstate service, and state commissions, which regulate intrastate service. Carriers must use a process called jurisdictional separations to apportion their costs and revenues between the state and interstate jurisdictions. The separations procedures are set forth in Part 36 of our rules.[14] The independent auditor found that BellSouth apparently violated our rules in separating its investment in information origination/termination equipment and cable and wire facilities. According to the record,[15] these violations may have continued beyond the audit period.

C. Other Apparent Errors

11. The independent auditor also found a number of other apparent rule violations, including BellSouth's failure to provide adequate documentation to support numerous revenue and cost adjustments,[16] and its improper inclusion of presubscription revenues[17] for the predesignation of interexchange carriers[18] in Account 5081, Enduser revenue.[19] The independent auditor also noted that a BellSouth operating company incorrectly reported an accrual adjustment to NECA resulting in an overstatement of CL revenues which would apparently violate Section 69.605 of our rules.[20] As such errors and other violations accumulate, the data carriers report to NECA under Section 69.605 of our rules[21] and to us under Parts 43 and 65 of our rules[22] become increasingly unreliable. Although these errors may have no current impact on BellSouth's interstate rates, their number and scope persuade us to order BellSouth to show cause why its internal accounting and accounting-related processes should not generally be brought into compliance with Commission rules and orders.

III. DISCUSSION AND CONCLUSION

A. NALs

12. We find that the BellSouth carriers' conduct appears to be inconsistent with their statutory obligation to maintain their accounts, records, and memoranda as prescribed by the Commission. Carriers must accumulate, process, and report their financial and operating data in accordance with very specific Commission requirements because we rely on those data to help us ensure that interstate telephone rates are just and reasonable. Moreover, we cannot evaluate how well our accounting rules work if carriers disregard or misinterpret these rules. Therefore, where, as appears to be the case with BellSouth, carriers either intentionally violate our rules or fail to maintain the internal systems necessary to ensure compliance with those rules, we believe forfeitures may be appropriate under Section 220 of the Act.[23]

13. Section 220(d) of the Act authorizes us to impose forfeitures of up to $6000 per carrier per day for accounting-related violations.[24] Obviously, any violations that continued throughout the audit period and to the present could trigger substantial sums for the two BellSouth companies based on appropriate application of the statute of limitations. In order to make a determination about the amount of any forfeitures that may lie, we direct BellSouth to state when the conduct described in paragraphs 8 through 10 and detailed in Attachment A ceased, if ever, and otherwise show cause why notices of apparent liability pursuant to section 1.80 of the Commission's rules should not issue.[25] BellSouth's response should include a discussion of the appropriate application of the prescribed limitations period.[26] BellSouth's response also should identify any mitigating circumstances we should consider in determining forfeiture amounts.[27]

B. Adjustments to Price Cap Indexes

14. As indicated above, BellSouth did not provide estimates of the impact on interstate services rates and revenue requirements of certain conduct described in the independent auditor's findings.[28] So that we may assess the full impact of BellSouth's conduct, we order the BellSouth carriers to estimate the interstate impact of each of these findings, and to file those estimates with the Commission. This filing shall include estimates of the effect of each of the additional findings on BellSouth's CL, TS, special access, billing and collection, and interexchange costs and

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13 *Attachment A*, at 2.

14 47 C.F.R. Part 36.

15 *Attachment A*, at 4-5.

16 *Id.*, at 8-9.

17 Presubscription revenues refer to the charges that LECs assess when an end user decides to change his or her primary interexchange carrier.

18 Under our rules, an end user has the right to select one interexchange carrier as his or her primary carrier. *See Investigation of Access and Divestiture Related Tariffs*, 101 FCC 2d 911 (1985) (describing the presubscription process LECs must follow).

19 *Attachment A*, at 9-10. Section 32.5081 of our rules, 47 C.F.R. § 32.5081, states that the end user revenue account (Account 5081) shall contain the federally tariffed monthly flat rate charge end users must pay. The independent auditor found that BellSouth improperly included presubscription revenues, from its customers' predesignation of their primary interexchange carriers, in Account 5081.

20 *Id.* at 9.

21 47 C.F.R. §69.605.

22 47 C.F.R. Parts 43, 65.

23 Section 220(d) provides for forfeitures if a carrier fails to keep its accounts, records and memoranda in the manner prescribed by the Commission. 47 U.S.C. §220(d).

24 47 U.S.C. §220(d). Prior to December 19, 1989, the forfeiture amount was fixed at $500 per violation per day.

25 47 C.F.R. §1.80.

26 Although BellSouth's violations began January 1, 1988, we would assess forfeitures only for the period allowed for by limitations period. *See* 47 C.F.R. §1.80(c)(2).

27 *See* 47 U.S.C. §504(b).

28 *See supra* note 9. These findings are discussed in paragraphs 19 through 21 of Attachment A.